MONTHLY BOND LETTER

AlphaFixe Capital

APRIL 2020

ECONOMIC EVENTS

- Employment in Canada fell by 2 million in April, bringing the unemployment rate to 13%, up 7.8%. Quebec, the epicentre of the pandemic in the country, was hit hard by this crisis, losing 821,000 jobs, or 41% of all jobs lost in the country. The unemployment rate now stands at 17%, an all-time high. However, many people (1.1 million) were not counted as unemployed because they did not look for work during the period under review. As businesses closed, opportunities to find work were limited. If these individuals were counted, the unemployment rate would have risen to 17.8%.

Although this is a historical loss of jobs, this figure underestimates the impact of the COVID on employment. In addition to the 1.1 million people not counted as unemployed, 2.5 million workers worked less than half their usual hours. The under-utilization of work is therefore major. The Canadian Emergency Response Benefit (CERB) could hinder job recovery. Why return to work if CERB provides $12.50 full-time for 4 months at home?

- The U.S. economy also came to a standstill at the end of March, causing a 4.8% annualized GDP contraction in the first quarter. Lockdown measures led to a drop in household consumption spending (-7.6%), particularly vehicle sales, health services and restaurants. Food consumption, on the other hand, surged. Business investment fell (-8.6%), but residential real estate expanded sharply (21%), which will be difficult to sustain. Foreign trade contributed to growth only because imports fell more than exports.

This contraction occurred with only two weeks of lockdown. So the second quarter will be a disaster. A drop of almost 40% in GDP cannot be ruled out, especially since employment fell by 20.5 million in April alone. This pandemic will therefore have wiped out all the jobs created since the recovery in June 2009. Once the confinement is lifted, the economy will at best be operating at 75% of its initial capacity.

- Affected by the COVID-19 before North America, the euro area economy contracted by 14.4% in the first quarter, the worst performance for GDP since it began being recorded (1995). France, Spain and Italy, which were hit hard by the pandemic, recording sharp falls in activity. In contrast, Sweden (outside the area), who did not apply strict confinement measures, saw its economy shrink by 1.2% over the same period.

The European Commission forecasts a 7.4% drop in GDP this year and is concerned about the eurozone stability. The countries of the south, which have been seriously affected, are calling for aid, but Germany and the Netherlands are still taking a hard line. Without a concerted response, the battered nations will feel abandoned by this concept of union.

RATE TRENDS

- The Bank of Canada has expanded its monetary stimulus by introducing two new asset buyback programs. In addition to the provincial treasury bill buyback program, the Bank announced a $50 billion provincial bond purchase program. The Bank will also purchase $10 billion in Canadian corporate bonds with a term to maturity of 5 years or less and a minimum credit rating of BBB-. The terms and conditions of this program are expected to be released shortly. These two new programs will be in effect for a 12-month period starting in May 2020.

- The Federal Reserve has specified certain details of its corporate bond buyback program. The $750 billion program will allow the Fed to buy bonds on the primary and secondary market with a minimum credit rating of BBB- as of March 22. Securities downgraded since that date will therefore be eligible for the buyback program.

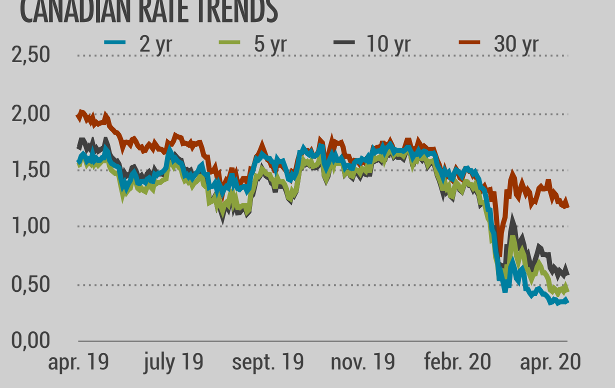
While the intent of these programs is worthy in the short term and aimed at improving liquidity in financial markets, the long-term consequences should not be overlooked. By accepting high-yield bonds, the Fed is creating a moral hazard by sending the message that the government will be there to save you even if you put your balance sheet at risk. This keeps zombie companies alive that should be penalized for borrowing to buy back their shares. However, borrowing is made possible primarily because monetary policy is too expansionary and encourages risk-taking. This is a vicious circle from which the Fed will find it difficult to escape without breaking out.

BOND RATES

April 30, 2020		Monthly Change	Change 2020		Monthly Change	Change 2020
Key Interest Rate	0,25 %	0,00 %	-1,50 %	0,25 %	0,00 %	-1,50 %
3 months	0,26 %	0,01 %	-1,40 %	0,08 %	0,02 %	-1,46 %
2 years	0,31 %	-0,11 %	-1,39 %	0,20 %	-0,05 %	-1,37 %
5 years	0,39 %	-0,20 %	-1,30 %	0,36 %	-0,02 %	-1,33 %
10 years	0,55 %	-0,15 %	-1,16 %	0,64 %	-0,03 %	-1,28 %
30 years	1,13 %	-0,18 %	-0,64 %	1,28 %	-0,04 %	-1,10 %
RRB 30 years	0,16 %	-0,15 %	-0,22 %			

Source: Bloomberg

CANADIAN RATE TRENDS



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CREDIT BOND RISK PREMIUMS

ISSUER	Credit rating DBRS S&P	Spread 5 yrs	Spread 10 yrs	Spread 30 yrs	Change 5 yrs month	Change 5 yrs 2020	Change 10 yrs month	Change 10 yrs 2020	Change 30 yrs month	Change 30 yrs 2020
Royal Bank, Bail-in Debt	AA	155	185	220	-90	70	-85	65	-80	60
Royal Bank, NVCC	A	225	255	290	-105	105	-100	85	-95	80
Sun Life, Subordinated debt	A	205	235	270	-105	105	-100	90	-95	85
Hydro One	A high	120	145	175	-55	60	-50	60	-40	45
Enbridge Inc	BBB high	240	275	310	-90	140	-90	125	-105	90
Altalink LP	A	115	140	170	-55	60	-50	60	-40	50
GTAA	A high	130	150	180	-55	75	-60	70	-55	70
Bell Canada	BBB high	155	185	240	-100	55	-95	35	-80	35
Rogers Communications	BBB	150	180	235	-100	55	-95	35	-80	30
Loblaw	BBB	145	175	230	-115	40	-110	20	-95	20
Canadian Tire	BBB high	210	240	295	-55	110	-50	90	-35	90
Province Québec	AA low	58	81	94	-29	22	-35	22	-26	25
Province Ontario	AA low	60	84	97	-28	22	-34	22	-26	24
SCHL	AAA	40	48	---	-10	11	-17	10		

Source: National Bank Financial

CREDIT MARKET

- Canadian corporate bond new issuance reached $18.5 billion in April, up $7.6 billion from the previous month and $11.3 billion more than in April 2019. This is a monthly record for new issuance, far surpassing the previous record set in September 2015 ($13.2 billion) and also surpassing the months following the collapse of Lehman Brothers in September 2008. This favourable credit environment since the Bank of Canada's announcement allowed TD Bank to secure the largest bond financing in history for a Canadian company ($3 billion for a 5-year term). Records are also being set in the U.S. where investment grade issuers raised a total of $296.6 billion in April, bringing the 2020 total to an all-time high of $807.1 billion.

- Demand for credit securities has been propelled by central bank support programs, but the rating agencies actions reflected an entirely different reality. Since the beginning of the year, S&P has downgraded or placed on negative watch, 20% of the companies and sovereign issuers it rates. This proportion rises to more than 60% for the most affected sectors, such as automotive and entertainment. In the first quarter alone, S&P issued 17 credit enhancement notices for every 100 downgrades. Last year, the number of upgrades was 53 per 100 downgrades. Defaults are also on the rise. In the first four months of the year, S&P had 62 defaults, 31 of which occurred in April alone. The retail, restaurant, entertainment, and oil and gas energy industries were the most affected.

- Real estate investment trusts (REIT's) were also disrupted by COVID as retail merchants struggled to pay their rent. H&R REIT, which owns several shopping malls in Canada, collected only 56% of the rents owed in April by its retail tenants and 40% if they are located in a mall. In contrast, virtually all office tenants paid their April rent. The situation is similar for RioCan REIT, which collected 66% of the retail tenants' rents, but 96% of the residential tenants' rents. The federal tenant assistance program may improve the situation in May.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	Apr. 2020	2020
Universe	100 %	3,79 %	5,41 %
Short Term	40,7 %	1,33 %	3,20 %
Mid Term	23,3 %	3,32 %	6,74 %
Long Term	36,0 %	7,07 %	7,24 %
Federal	34,4 %	1,55 %	6,76 %
Provincial	37,3 %	5,22 %	6,57 %
Corporates	26,2 %	4,75 %	2,15 %
RRB		3,57 %	3,62 %

Source: ftse.com

Central bankers may intervene to help companies obtain financing by supporting demand for bonds, but they cannot help them to boost revenues to pre-crisis levels. This new economic reality is being expressed by the agencies and the sea of downgrades and bankruptcies is only just beginning. Fundamental analysis is therefore more essential than ever.

Many argue that this pandemic will change the way we shop and work in the future, reducing the need to lease as much square footage.Change was also present after the attacks on New York in 2001, when the future of skyscrapers was doomed. However, the reality was quite different. It is too early to bury malls and office buildings.

STRATEGIC POSITIONNING

In just 6 weeks, the U.S. Congress adopted relief measures totalling US$3.6 trillion, an unprecedented mobilization that demonstrates the scope of the economic disaster. To finance this spending, the U.S. Treasury will issue a record $3 trillion in bonds in the second quarter alone and more than $4.5 trillion this year. Such borrowing would not be possible without the Federal Reserve, which increased its balance sheet by $2.4 trillion in a few weeks by buying Treasury bonds and mortgage-backed securities. These purchases are the equivalent of what the Fed did for three years after the financial crisis. As a result, the U.S. money supply (M2) is up 20% year-over-year, compared to an increase of only 10% during the financial crisis. The Fed has also put forward a buyback program for municipal, corporate and state bonds that is expected to begin shortly. In all, U.S. monetary and fiscal intervention totals $8,300 billion, or the equivalent of $25,000 per person, which will be injected into the financial markets and the economy, and there is more to come. Congress is already working on a new spending program. The unprecedented increase in debt and the money supply will have significant mid- and long-term consequences on the vitality of the economy and inflation. The Fed believes it can withdraw liquidity in time. It was difficult after 2008, it will be almost impossible after Covid.